Copied to:

STAT

[redacted] OGI

OEA

Route to:
C/NIC
VC/NIC
NIO/AL - Hans
NIC/AG - Sid

Approved For Release 2008/08/20 : CIA-RDP85-01156R000100120008-6

EXECUTIVE SECRETARIAT

Routing Slip

TO:		ACTION	INFO	DATE	INITIAL
1	DCI				
2	DDCI				
3	EXDIR				
4	D/ICS				
5	DDI				
6	DDA				
7	DDO				
8	DDS&T				
9	Chm/NIC				
10	GC				
11	IG				
12	Compt				
13	D/EEO				
14	D/Pers				
15	D/OEA				
16	C/PAD/OEA				
17	SA/IA				
18	AO/DCI				
19	C/IPD/OIS				
20	AO/ECOM		✓		
21					
22					
	SUSPENSE _____ Date				

Remarks:

STAT

D/ Executive Secretary

4/21/83

Date

3637 (10-81)

THE WHITE HOUSE
WASHINGTON

CABINET AFFAIRS STAFFING MEMORANDUM

DATE: 2-18-83 NUMBER: 118509CA DUE BY: _____

SUBJECT: Cabinet Council on Economic Affairs - Tuesday, February 22, 1983
8:45 a.m. Roosevelt Room

	ACTION	FYI
ALL CABINET MEMBERS	☐	☐
Vice President	☑	☐
State	☑	☐
Treasury	☑	☐
Defense	☐	☑
Attorney General	☐	☑
Interior	☐	☑
Agriculture	☑	☐
Commerce	☑	☐
Labor	☑	☐
HHS	☐	☑
HUD	☐	☑
Transportation	☑	☐
Energy	☐	☑
Education	☐	☑
Counsellor	☑	☐
OMB	☑	☐
CIA	☐	☑
UN	☐	☑
USTR	☑	☐
CEA	☑	☐
CEQ	☐	☐
OSTP	☐	☐
_____	☐	☐
_____	☐	☐

	ACTION	FYI
Baker	☑	☐
Deaver	☐	☐
Clark	☐	☑
Darman *(For WH Staffing)*	☑	☐
Harper	☑	☐
Jenkins	☐	☑
_____	☐	☐
_____	☐	☐
_____	☐	☐
_____	☐	☐
_____	☐	☐
_____	☐	☐
_____	☐	☐
CCCT/Gunn	☐	☐
CCEA/Porter	☑	☐
CCFA/Boggs	☐	☐
CCHR/Carleson	☐	☐
CCLP/Uhlmann	☐	☐
CCMA/Bledsoe	☐	☐
CCNRE/Boggs	☐	☐

REMARKS: The Cabinet Council on Economic Affairs will meet Tuesday, February 22, 1983 at 8:45 a.m. in the Roosevelt Room. The agenda and papers are attached.

RETURN TO:

☐ Craig L. Fuller
Assistant to the President
for Cabinet Affairs
456-2823

☑ Becky Norton Dunlop
Director, Office of
Cabinet Affairs
456-2800

THE WHITE HOUSE

WASHINGTON

February 17, 1983

MEMORANDUM FOR THE CABINET COUNCIL ON ECONOMIC AFFAIRS

FROM: ROGER B. PORTER RBP

SUBJECT: Agenda and Papers for the February 22 Meeting

The agenda and papers for the February 22 meeting of the Cabinet Council on Economic Affairs are attached. The meeting is scheduled for 8:45 a.m. in the Roosevelt Room.

The first agenda item is a review of developments in the thrift industry. The last time that the Council reviewed developments in the thrift industry was in August 1982. Since then much has happened with passage of the Garn-St. Germain Depository Institutions Act, implementation of the capital assistance provisions of the legislation to institutions encountering temporary earnings problems, and the introduction of money market deposit accounts. A memorandum from Roger W. Mehle, chairman of the Thrift Industry Working Group, describing these developments is attached.

The second agenda item is a report from the Working Group on Crude Oil Decontrol and the Windfall Profit Tax. On November 1, the Cabinet Council established a Working Group to complete preparation of a report required by the Crude Oil Windfall Profit Tax Act of 1980. The Working Group, which includes representatives from the Departments of State, the Treasury, Commerce, and Energy, the Office of Management and Budget, the Council of Economic Advisers, and Office of Policy Development, and the National Security Council staff has met several times over the last three and a half months. A memorandum from Danny J. Boggs, chairman of the Working Group, describing the major findings of the study and raising the issue of whether the study should be revised in light of recent oil price developments is attached. The draft executive summary chapter of the study is also attached.

Attachments

THE WHITE HOUSE

WASHINGTON

THE CABINET COUNCIL ON ECONOMIC AFFAIRS

February 22, 1983

8:45 a.m.

Roosevelt Room

AGENDA

1. Status Report of the Thrift Industry (CM#34)

2. Report of the Working Group on the Effects of Oil Decontrol and the Windfall Profits Tax (CM#349)

CM#34

DEPARTMENT OF THE TREASURY
WASHINGTON, D.C. 20220

ASSISTANT SECRETARY

February 17, 1983

MEMORANDUM FOR THE CABINET COUNCIL ON ECONOMIC AFFAIRS

FROM: Roger Mehle

SUBJECT: Review of Thrift Industry Developments

Current Legislation and Its Implementation

The Garn-St Germain Depository Institutions Act, which was in large part inspired by the Cabinet Council on Economic Affairs (CCEA), was signed by the President on October 15, 1982.

The Act gives thrift institutions a broader range of powers, including some commercial loan authority for savings and loan associations, which will help these institutions to operate profitably throughout future interest rate cycles. The Act also permits the Federal deposit insurance agencies to authorize the acquisition of troubled institutions on an interindustry and interstate basis. Both of these results were important objectives of the CCEA from its earliest deliberations in 1981 on the difficulties of the thrift industry.

Capital Assistance. The legislation also authorized the Federal Deposit Insurance Corporation (FDIC) and the Federal Savings and Loan Insurance Corporation (FSLIC) to provide "capital assistance" to institutions encountering temporary earnings problems. The aid is in the form of promissory notes which are exchanged for "net worth certificates" issued by the capital-short institutions. This non-cash, non-deficit contributing concept was devised in the CCEA in mid-1981 and was furnished to the thrift regulatory agencies for detailed development.

By the end of 1982, the FDIC had purchased $175 million in net worth certificates from 15 qualified savings banks; no additional certificates have been purchased through February 14, 1983. With the maintenance of current interest rates, there will be only a handful of additional recipients. (The six-month Treasury bill rate is currently 8.25 percent.)

The FSLIC is now accepting applications from savings and loan associations that qualify for the program but does not expect to issue promissory notes until March or April of 1983. The FSLIC estimates that to assist thrift institutions with net worth of three percent or less under this program the FSLIC will provide $1.02 billion in capital assistance this year.

Before the passage of the Garn St-Germain Act, the FSLIC, at the urging of the CCEA, established similar kinds of assistance programs. Under these programs the FSLIC from September 1981 through January 1983 purchased approximately $440 million of net worth certificates from seven savings and loan associations.

Money Market Deposit Account. The Garn-St Germain Act provided for the Depository Institutions Deregulation Committee (DIDC) to authorize a new account for commercial banks and thrift institutions which would compete directly with money market funds (MMFs), an objective of long standing of the DIDC. The understanding between the Administration and Congress which gave rise to this provision was that the thrift industry would receive increased asset powers if all depository institutions, especially banks, would receive an interest rate ceiling-free, no-differential, demand-type deposit account. The money market deposit account (MMDA), which became effective December 14, 1982, has been enormously successful; for the week ending February 2, 1983 outstanding MMDAs at all depository institutions averaged about $233 billion, which compares with a MMF volume just before the MMDA became effective of $230 billion. Although it is difficult to identify the sources for this huge volume of deposits, the regulatory agencies estimate that between 15 and 30 percent is "new" money to depository institutions and that the remaining portion comes from their own maturing money market certificates, retail repurchase agreements, passbook accounts, and other deposit accounts.

The DIDC also authorized a new market rate, unlimited checking "Super NOW" account that became effective January 5, 1983. For the week ending February 2, the volume of deposits in this account was estimated to be $18.3 billion. The initial volume was considerably less than that for MMDAs because the account has not been promoted as heavily as the MMDA.

Thrift Industry Statistics

At the end of December 1982, aggregate net worth for insured savings and loan associations was $25.1 billion, down $2.5 billion for the year, compared with a $4.8 billion decline in 1981. The net worth figure, however, started to increase in October 1982 and improved each month thereafter, for a total increase of $1.4 billion in the fourth quarter. Year-end net worth figures are not yet available for mutual savings banks, but according to the National Association of Mutual Savings Banks (NAMSB) the industry should experience losses equal to $1.3 billion in 1982, compared with losses of $1.4 billion in 1981. The industry's net worth also began improving in late 1982.

Deposit flows at savings and loan associations started to improve in November 1982 and at mutual savings banks in early December as many institutions started promotional campaigns for the MMDA and the Super NOW account. Savings and loan association deposits rose by $36.5 billion in 1982 compared with only a $13 billion increase in 1981. Mutual savings bank deposits increased by $4.5 billion in 1982 compared with $0.7 billion in 1981. The preliminary January data for savings and loan associations indicate that net new deposits, which include both of these new accounts, equaled a remarkable $14 billion.

By the end of December 1982, savings and loan association assets had reached $693 billion, or about 9 percent above the year-end 1981 level. Assets for the savings bank industry were $172.2 billion at the end of November 1982, having increased 1.5 percent over the year-end 1981 level.

During 1982 there were 77 savings and loan associations involved in mergers and other transactions involving FSLIC assistance. However, insurance premiums and income on investment raised the FSLIC fund balance to $6.4 billion by the end of December 1982, as compared with $6.3 billion at the end of 1981. The FDIC handled 8 mutual savings bank mergers in 1982. The FDIC fund balance was $13.8 billion at the end of 1982, compared with about $12.2 billion at the end of 1981.

Summary

During 1981 and 1982, the thrift industry experienced severe losses because of high interest rates which drained their fixed-rate, lower-yielding deposits and caused their

average cost of funds to exceed average income from investments. There were many during that time that sought radical solutions to the thrift industry's problems, including granting the full faith and credit of the U.S. Government to insured deposits, increasing the borrowing authority of the insurance agencies, and providing mortgage interest rate subsidies; all of which would have cost billions of dollars or done great damage to the free market principles of the Administration, or both. The CCEA rejected these proposals and produced a pro-competitive Administration response, operating within the framework of the Reagan program and the depository institutions' regulatory system. This response, embodied entirely in the Garn-St Germain Act, together with declining interest rates, has largely redressed the crisis confronting the thrift industry. The CCEA should be gratified with the results of its effective and inexpensive handling of this serious situation.

CM#349

THE WHITE HOUSE

WASHINGTON

February 17, 1983

MEMORANDUM FOR THE CABINET COUNCIL ON ECONOMIC AFFAIRS

FROM: DANNY J. BOGGS, CHAIRMAN
WORKING GROUP ON STUDY OF WINDFALL PROFIT TAX
AND CRUDE OIL DECONTROL

The Crude Oil Windfall Profit Tax Act of 1980 required the preparation of a report by January 1, 1983, which would address the effects of crude oil decontrol and of the Windfall Profit Tax (WPT) on the following items: domestic oil production, oil imports, oil industry profits, inflation, employment, economic growth, federal revenues, and national security.

Major drafting work and funding for contractor studies has been done by the Department of Energy, with significant consultation and critiquing by the Department of the Treasury. Treasury's Office of Tax Analysis is responsible for the chapter on Federal Revenues, which has not yet been prepared. Pursuant to direction, a Working Group of the Cabinet Council on Economic Affairs was formed with membership from the Office of Policy Development, the Office of Management and Budget, the Council of Economic Advisers, the National Security Council, Energy, Commerce, State, and Treasury. This Working Group has met on several occasions, with extensive informal consultation between Energy, Treasury, the Council of Economic Advisers, and the Office of Policy Development.

The work done so far, and embodied in the attached draft Executive Summary chapter, has the following major findings (all dollar values given are net present value for the period 1980-1995):

1. Decontrol has led to increased oil production of about 1 million barrels a day compared to expected levels under continued price controls. This is a long-term gain to the economy. The existing Windfall Profit Tax reduces production below what would have occurred without it by amounts ranging from 400,000 barrels a day in the early 1980s, to 100,000 barrels in the late 1980s. Since oil production deterred by Windfall Profit Tax remains available for future production, the analysis shows higher production in the 1990s with the Windfall Profit Tax than without it.

2. By causing increased production, both decontrol and the absence of the Windfall Profit Tax correspondingly decrease oil imports. On the other hand, continued controls would have had the net effect of increasing imports by a total of 6 billion barrels over the decade of the 1980s.

3. Oil industry profits would have been significantly reduced by continued controls, and industry investment would have been reduced much more. Similarly, the Windfall Profit Tax reduced profits and oil industry investments. Continued oil price controls would reduce oil industry profits by about $27 billion, while the Windfall Profit Tax reduces industry profits by about $57 billion relative to a removal of the tax.

4. Over the long term, price controls on oil were inflationary because of the inflationary impact of economic efficiency losses. The years of price controls raised the price level by about 2 percent.

5. Employment effects are quite minor, although for the same reasons as with inflation, employment is somewhat higher without controls. The employment effect is less than .2 percent.

6. Economic Growth and Economic Efficiency. Although this area is somewhat controverted as to the exact means of calculation, it appears that decontrol improved American economic performance by more than $300 billion in net present value. The Windfall Profit Tax similarly imposes economic costs of more than $20 billion.

7. National Security. The reduction in imports from decontrol has the effect of allowing any given level of Strategic Petroleum Reserve (SPR) to cover a substantially greater period of interruption. For example, the current 300 million barrel SPR would replace all of our imports from Arab OPEC countries for about a year. If those imports were 1.7 million barrels a day higher, a likely result of continued controls, then our current SPR would only cover the loss of those imports for only about 120 days.

The general conclusion of the report is that by almost every measure, the removal of oil price controls has improved indices of economic performance. The removal of the Windfall Profit Tax would similarly improve almost all indices of performance, but would, of course, result in a significant loss in federal revenues.

The summary given above is based on the draft currently done by the Department of Energy. The Working Group meeting revealed the following significant items of continuing disagreement.

1. This analysis is based on an oil price path in common use last summer when the study was begun, showing only a small decline in real oil prices between 1982 and 1983, and increases in real prices thereafter. The Department of Treasury's position has been that the study needs to be redone using an oil price path more consistent with current budget assumptions and general expectations, which involve considerably lower oil prices.

2. This study was done using a particular demand function, involving a one-time elasticity response to changes in prices. All members of the Working Group agree that it would be possible to create a more sophisticated demand function involving differing demand responses to price, growing over time.

3. The measurement of economic efficiency by real income available for consumption and investments is derived from work done by DOE's contractor, Dale Jorgensen. There is continuing controversy as to the appropriateness of using this particular measure in the report, as opposed to more traditional measures of GNP.

Two basic courses of action are open. We can proceed to complete the report in essentially its present form. Appropriate caveats can be added to indicate qualitatively the effect of a lower price path or of a more detailed demand specification. The economic measures can be presented by appropriate description of alternative possibilities without dogmatically supporting one or the other as absolutely correct. Under this scheme, the report could be finished for final circulation within 2-4 weeks.

An alternative approach would be essentially to redo the study, especially redoing the runs using a lower price path and different demand specifications. This would probably delay ultimate presentation of the report by at least 90 days, but Congress could be assuaged by an indication that conditions in the oil market have been changing so rapidly that a sensible study simply requires more time to take them into account.

Those arguing for this course of action also indicate that the additional time could be useful to ensure both technical and policy consistency of the methodology and conclusions of this report with the material that will be necessary for the presentation and explication of the Administration's proposed contingent standby oil excise tax.

The Working Group has thus far been unable to reach an agreement on which of these two courses to pursue.

2-16-83

DRAFT

A Report to Congress on the Effects of Decontrol of Oil Prices and of the Windfall Profit Tax

EXECUTIVE SUMMARY

I. Introduction

This study has been prepared in response to the mandate of Section 103 of P.L. 96-223, the Crude Oil Windfall Profit Tax Act of 1980. The law requires a study that addresses effects of decontrol and the Windfall Profit Tax (WPT) on domestic oil production, oil imports, oil industry profits, inflation, employment, economic growth, Federal revenues, and national security.

This report examines each of these areas by comparing outcomes under actual law with estimated outcomes under several hypothetical policy alternatives. Oil price controls reduced financial returns to U.S. oil producers and, thus, deterred some marginal investments in production. Imposition of the WPT had a similar effect, though smaller in magnitude. In the models used for estimating policy impacts, any policy which reduces U.S. production relative to demand, increases import requirements, and contributes to upward pressure on world oil prices. Higher world oil prices increase the volume of U.S. goods and services (or money representing future claims on goods and services) that must be exchanged to foreigners to satisfy U.S. energy demand.

Estimates of the impact of oil price controls and the windfall tax are developed by translating oil policies into price impacts, production impacts, world oil market effects, investment effects for all domestic industries and, ultimately, productivity and real income affects. The findings at each stage of the analysis are summarized below and described in detail in the following chapters.

The major findings are that oil price controls substantially impaired the ability of the U.S. economy to produce the intermediate and final output that buyers would have purchased. Oil price controls diverted capital and labor from oil projects into less productive uses while oil was increasingly purchased at world prices that exceed production costs in the domestic oil industry. The WPT had the same effect but to a lesser degree because it reduced oil producers incomes by only half as much as price controls.

In all cases, the losses in economic efficiency are measured by the value of production lost due to diversion of labor and capital from their most productive uses by price controls and the windfall tax. The production loss is reported as the cumulative impact, 1980-1995 measured by consumer prices.

The WPT is a particularly burdensome tax on the economy because it motivates resource shifts among industries for tax avoidance rather than profit opportunities. Substitution of an income tax for the WPT would increase economic efficiency and consumption opportunities although GNP would not necessarily rise. This is largely because GNP is a poor measure of the effect of increasing efficiency on economic performance

II. Domestic Oil Production

U.S. oil production declined from 9.4 million B/D in 1971 to 8.6 million B/D in 1980. A variety of oil price controls were in effect during that time. It is estimated that 1990 production will be at the rate of 7.1 million B/D under actual law and uncontrolled prices. Continuation of price controls of the type in place in 1979 (before phased-decontrol began) would have further reduced U.S. oil production to 5.9 million B/D by 1990. Continuation of stringent price controls would have

reduced domestic oil production by 1.2 million B/D in 1990 and by an average of 1.0 million B/D over the 1981-1990 period, compared to the policy of oil price decontrol.

The WPT enacted in 1980 restricted U.S. oil production by reducing the profitability of U.S. oil investments and by reducing the cash flow of oil producers. If the WPT had not been enacted, U.S. oil production would have been about 430,000 B/D higher in the early 1980's when the WPT constituted its greatest deterrent to investment. By the late 1980's, when producers could have anticipated the phase-out of the WPT according to its own "sunset" provision, the WPT reduced domestic oil production by about 110,000 B/D. The WPT of 1980 actually increases post-1990 production because lower production in the 1980's leaves more oil in the ground for subsequent recovery. The WPT imposes some economic costs by reducing U.S. oil production during the 1980's, but the tax serves primarily to postpone rather than permanently reduce domestic oil production. The delay does, however, cause some permanent production losses, and postpones some production that had its greatest value earlier in the decade.

Repeal of the Tier 3 WPT applicable to newly discovered and other additional sources of domestic production holds some promise for increased domestic production without large revenue losses. Repeal of the Tier 3 tax would increase 1983-1990 production by about 90,000 barrels per day by making newly discovered and other tier 3 oil more profitable.

III. Oil Imports

U.S. oil imports have declined since their 1977 peak of 8.6 million barrels per day (net of exports). By 1982, imports of crude oil and refined products had declined to 4.1 million barrels per day (net of exports and SPR purchases). Further

declines occurred in 1982. The estimated impact of the studied policies are reported as adjustments to the declining trend in U.S. oil imports since 1978.

Under the assumption of continued price controls, U.S. imports would rise by 1.7 million B/D in 1985 and by 1.6 million B/D in 1990, compared to actual policy. Over the 1981 to 1990 period, decontrol is expected to reduce oil imports by 6 billion barrels. For the purpose comparing magnitudes, even the 1 year import reduction from decontrol greatly exceeds the Strategic Petroleum Reserve inventory.

The WPT also impedes domestic production and adds to import requirements. Repeal of the tax, or selective reductions in its coverage, would therefore reduce import requirements. The expected impact of never having enacted the WPT would be to reduce 1985 imports by 330,000 B/D and leave 1990 imports unchanged (the WPT would expire by its own provisions about that time). Exemption of new oil from the WPT could reduce imports by 55,000 B/D in 1985 and by 82,000 B/D in 1990. The WPT will have increased U.S. import requirements by 890 million barrels through 1990. Repeal of the Tier 3 WPT would reduce import needs by 290 million barrels through 1990.

Reduction of U.S. import requirements does not benefit the U.S. economy by the full reduction in the oil import bill. The imported oil is replaced largely by domestically produced energy which involves use of valuable labor and capital as well as depletion of U.S. oil reserves. There are economic benefits from the replacement of costly imports with generally cheaper domestic production, and lessened import demand tends to hold down world oil prices. Nonetheless, reduced expenditures for foreign oil also reduce foreign purchases of U.S. products, so the net gain to the U.S. economy from import reduction is significantly less than the dollar reduction in U.S. purchases of foreign oil.

IV. Oil Industry Profits and Investment

Oil industry profits were estimated from after-tax prices under the various policy alternatives and from the costs of producing the quantities of oil that the U.S. industry would supply under the various policies examined. Profit differences are reported as 1982 present values, showing the current cost (or benefit) in 1982 dollars of the various alternatives to the industry as a whole or its shareholders.

Continuation of price controls would reduce industry profits over the 1980-1995 period by a present value of $27 billion. The profit loss would be larger but for an anticipated reduction in oil industry investment of more than $200 billion in response to the reduced profits available under pre-1979 price controls.

If the WPT had never been enacted, oil industry profits would have been $57 billion higher in present value terms than the estimated actual level for 1980-1995. These added profits are earned by investing $129 billion of additional capital in U.S. oil exploration and development and by the elimination of WPT liabilities.

Repeal of the Tier 3 WPT in 1983 would prompt the oil industry to increase U.S. investment by $4.7 billion through 1995 and permit increased profits with a present value of $9 billion more than under actual policy.

V. Inflation

Oil price controls and the WPT affect the rate of inflation in two significant ways. Policies that control oil prices, keep measured inflation rates down, but reduce economic efficiency by signaling the economy to use too much oil considering its

replacement cost. On the other hand, resource inefficiencies that accompany oil price controls limit full-employment GNP, and bring the economy closer to the inflationary brink. The reduced efficiency with which labor and capital are employed in nonenergy industries when they are barred from their most profitable applications in the oil industry raises costs and prices. Thus, the apparent anti-inflation benefits of price controls are offset by the inflationary impacts of consequential economic efficiency losses. The net result is that continued price controls compared to actual policy would raise prices slightly over a 15 year period.

Continuation of price controls would have raised the price level beginning in 1981. With continued strict controls, the price level would have been 2.4 percent higher in 1995 than the price level without controls. With controls, the annual inflation rate would have been 0.1 to 0.2 percent higher than without controls. Thus, the overall estimated impact of oil price controls on the inflation rate was minor.

The WPT also has very little impact on inflation rates. Repeal of the WPT with replacement revenues provided by a compensating increase in income tax rates would not have significantly changed measured inflation rates. Repeal of the WPT would have changed measured inflation rates by less than 0.1 percent annually. Reform or partial repeal of the WPT would have an even smaller impact on prices in the economy.

Repeal of the Tier 3 tax (new oil) in 1983 would not have any measurable impact on the reported rate of inflation through 1990.

VI. Employment

None of the price control or WPT policies examined caused significant changes in the size of the U.S. labor force. Therefore, employment levels under the various policies are closely related to the unemployment levels that occur under each policy.

In the base case, the U.S. unemployment rate is projected to decline slowly from present levels to 6.8 percent by 1990. In the case of continued price controls, the unemployment rate is projected to be 0.2 percent higher throughout the period during which controls reamin in effect. Controls reduce economic efficiency, but labor demand is maintained by continued investment in non-oil industries.

The unemployment effect of continued price controls is small. WPT repeal or partial repeal would have no measurable impact on unemployment levels.

VIII. Economic Growth

GNP, the conventional economic growth measure, does not adequately reflect the effect of oil policy changes on the economic performance of the economy. Oil price controls and the WPT actually increased GNP growth even while economic efficiency was reduced. Both policies encouraged investment spending, but diverted investment into areas of the economy other than oil where its productivity was less than it would have been in untaxed and uncontrolled oil uses. Since GNP reflects investment spending, even inefficient investments, GNP growth does not measure economic performance or impairments of performance. In the analysis performed, GNP over the 1980-1995 period was reduced by WPT repeal and WPT reduction even though

the economic efficiency and real incomes would rise. For these reasons we have relied on a more comprehensive measure of economic performance. Performance of the economy is measured by the real income provided to consuming units. Real income is available for immediate consumption or investment. The money measure used is an index of real income that does not depend on how households choose to divide income between investment or consumption.

IX. Economic Efficiency

Decontrol of oil prices restored free competition between domestic oil producers and foreign suppliers. Oil price controls were retained through the 1970s to protect consumers from high oil prices based on OPEC's market power. The controls reduced domestic production and increased import demand. Increased reliance on imported oil further increased OPEC's market power and contributed to higher world oil prices. The controls held down U.S. prices for petroleum products but raised world oil prices.

Higher levels of foreign oil imports result in wealth transfers from the United States to foreign suppliers. Policies which increase our import requirements and raise world oil prices enlarge those wealth transfers, thereby reducing domestic consumption levels. In this study a real income measure of economic well-being has been used to evaluate the costs of oil price controls and the WPT.

Although the real income households is used to evaluate the benefits of decontrol and the impact of the WPT, this measure reflects the value of benefits to both consumers and producers. Oil decontrol, for example, frees investors and producers to respond to the most profitable investment opportunities available, free of profit reductions caused by

the existence of price controls. Decontrol permits capital to go to its most productive uses rather than leaving investors to make second-best choices as under price controls. Some high cost oil imports are replaced by domestic production. Oil import replacement can be achieved with fewer productive resources that are needed to produce enough other goods to pay the added cost of oil imports. The additional resources available after the return to efficiency are available to produce both consumer and investment goods thereby lowering all prices and raising real incomes. The value of lower prices throughout the economy is measured as equivalent real income to consuming units, but because both producer and consumer prices are affected, the increase in potential consumer welfare fully reflects both producer and consumer benefits. Even though measured GNP may go down as economic efficiency is improved, the Nation's economic demands are more fully satisfied.

Continued price controls are estimated to impose economic costs with a present value of $374 billion. Decontrol improved economic performance by an amount worth $374 billion to American consumers. Decontrol increased real incomes through improved productivity for both labor and capital, reduced foreign payments and increased value of the dollar relative to foreign currencies.

The WPT is expected to impose economic costs of $155 billion over the period 1980 to 1995. Some dislocation costs remain even after WPT phase-out in 1991. Repeal of the WPT in 1983 would avoid $93 billion in future economic costs. Either of these steps alone would increase the Federal deficit.

Replacing the WPT with an income tax that yielded equivalent revenues would avoid the inefficiencies that accompany an oil excise tax without worsening the Federal deficit. Enacting an

income tax levy in 1980 instead of the WPT on oil would have produced present value benefits of $93 billion for the 1980-1995 period. Replacing the WPT with an equivalent income tax in 1983 would produce benefits whose measured present value is $67 billion.

Reform of the WPT by removing the tax on newly discovered oil and other high cost production would increase domestic oil production enough to provide price and investment benefits worth $8 billion. This particular reform provides economic benefits vastly smaller than repealing the WPT or shifting to a more neutral tax on incomes.

X. Federal Revenues

To be provided by the Department of the Treasury.

XI. National Security

Policies which reduce the need for imported oil enhance national security. Although not all foreign oil comes from insecure or unstable regions, markets are connected so that total demand for imported oil ultimately determines how much will be needed from whatever foreign source may be jeopardized by a supply disruption. Decontrol of oil prices and reduction or repeal of the WPT reduce oil imports and increase the share of U.S. petroleum supplied from domestic sources, and thereby contributing to national energy security.

An additional means of energy security is the ability of the SPR to replace oil imports in the event of a supply interruption. Oil price decontrol is estimated to have reduced U.S. oil import requirements by about 1.5 million barrels per day. At present import levels, that import reduction permits a

SPR of 300 million barrels to last approximately 48 days longer than if controls were in place, when the SPR is used to replace 50 percent of imports. Removal of the WPT would reduce oil import requirements by an additional 330,000 barrels per day by 1985 and if imports were at the 4 million barrel per day level, WPT repeal could add about 9 days to the life of the SPR in the event of a disruption. Exemption of new oil from the WPT would boost U.S. production and cut imports by such a small figure that the energy security benefits of the policy would be insignificant.In progress

XII. Legislative Recommendation

Legislative action could consist of repeal of the WPT, reduction in its effective rates or exemption of certain categories of oil production from WPT coverage. Declining world oil prices diminish the urgency of any change in the WPT, since at prices of $30 per barrel, further price declines reduce the WPT liabilities by 30 percent for every 10 percent drop in oil prices. Several possible WPT changes are briefly described here, and discussed more fully in Chapter ___.

Outright WPT repeal would provide the economic benefits described in Chapter ___ but would entail a revenue loss of approximately $100 billion through 1992 at the oil price path assumed for this study. Repeal of the WPT would stimulate oil production, further reduce import requirements and increase economic efficiency. The repeal would benefit large oil companies more than independent producers since the independents already pay far lower WPT rates than major producers.

Repeal of the WPT with revenue replacement from income tax sources would provide substantial gains in economic efficiency by restoring the incentive to make oil investments that would

be profitable without the WPT. Replacement of revenues by an income tax would not alter investment patterns within the economy, thus, avoiding efficiency losses while providing replacement revenues. Like WPT repeal, this policy would reduce relative tax burdens for the major oil companies that now bear the greatest WPT burdens.

Reducing the effective tax rates below the Tier 3 rate reductions already enacted as part of the Economic Recovery Tax Act of 1981 would provide partial benefits, of the type described above, to the economy. Partial rate reduction could be enacted with or without specific revenue replacement.

Exemption from the WPT for newly discovered oil and other categories of expensive production would encourage added production and boost the exploration on which future production depends. Exemption of newly discovered oil from the tax would, however, provide only a small fraction of the general economic benefits that are available from elimination of the WPT.

Declining oil prices sharply reduce the impact of the WPT on all oil producers. At world oil prices of $32 per barrel the WPT will produce revenues of about $11 billion in FY 1983. At world prices of $28 per barrel the WPT yield would drop to about $7 Billion and at $24 per barrel the receipts would drop to about $3.5 billion for FY 1983. Significant reductions in world oil prices could diminish the urgency or eliminate the need to legislate WPT changes. However, a recovery in world oil prices before 1992 would re-impose the economic costs that the WPT causes. Therefore, legislative changes may be worthwhile even during an interim period of low oil prices and low WPT liabilities.

Table 1.1: Legislative Options

	Economic Benefit, 1983 Present Value	
	Simple WPT Reduction	Revenue Replacement via Income Tax
1983 WPT Repeal	$ 93 billion	$ 67 billion
Repeal Tier 3 of WPT	$ 8 billion	$ 5 billion